Full Faith & Credit Act

Myth vs. Reality

Myth #1

The Full Faith and Credit Act will force the government to pay off foreign creditors at the expense of the American people.

Reality:

While foreign creditors own a significant share of our debt, the American people also own trillions of dollars of Treasury securities as well. This legislation would protect the millions of Americans, pension funds, unions and local governments who have invested in U.S. Treasuries.

Private pension funds own about $532 billion in U.S. debt. Public sector pension funds own another $174 billion. Americans who have invested in mutual funds own an additional $638 billion. On top of all this, American companies and individual investors own another $1.27 trillion in U.S. securities.

Myth #2

The government will be forced to cut Social Security or Medicare.

Reality:

According to the OMB, net interest payments and servicing of the debt is estimated to be $250 billion in FY 2011. These costs are fairly evenly spread out over the course of the year, meaning the average monthly expense would be $21 billion. In comparison, we are expected to collect about $2.567 trillion in taxes over the same time period. In the event that we do hit the debt limit, the government would continue to collect tax revenue. This bill would simply mandate that the first $21 billion would be used to prevent a catastrophic default on our debt.

Myth #3

The Treasury Department will be unable to prioritize debt service costs as required by this legislation because the Secretary of the Treasury lacks the authority to manage interest payments as they relate to fluctuations in the government's short term cash flow.

Reality:

Section 3123 of Title 31, U.S. Code states:

> (b) The Secretary of the Treasury shall pay interest due or accrued on the public debt. As the Secretary considers expedient, the Secretary may pay in advance interest on the public debt by a period of not more than one year, with or without a rebate of interest on the coupons.

The Treasury can therefore use its discretion to manage cash flow payments.

Myth #4

Prioritizing payments on the public debt would not prevent the negative economic consequences resulting from a government default. If the debt ceiling is reached, the markets will view the failure to pay government obligations separate from the public debt as a "default by another name."

Specifically, Secretary Geithner claims that prioritizing obligations on the debt held by the public would "merely be default by another name, since the world would recognize it as a failure by the U.S. to stand behind its commitments. It would therefore bring about the same catastrophic economic consequences Secretary Geithner has warned against…"

Reality:

The Full Faith and Credit Act would legally require that the government pay interest and principal costs on the public debt with existing revenue prior to paying other claims on the Federal Treasury. This legislation is designed to address market concerns on a temporary basis in the event the debt ceiling is reached. It is not intended to represent an alternative to raising the debt ceiling while enacting significant budget and spending reforms. This legislation is a last resort measure designed to prevent a Greek style sovereign debt crisis by guaranteeing that we do not default on our public debt obligations in the event the debt ceiling is reached temporarily.

Since Treasury Secretary Geithner decided to put the option of defaulting on the public debt on the table, investors and creditors would be justifiably concerned over our ability to fulfill these obligations. Any penalties and fees associated with delaying payments to contractors and vendors will be far smaller than the costs of a sovereign debt crisis. In the past, such payments have been made retroactively once impasses over the debt ceiling have been resolved.

The Treasury has had to manage the nation's finances on four separate occasions when the debt ceiling was reached. In each of these instances, in 1985, 1995-1996, 2002, and 2003, the Treasury Department took the very steps that Geithner claims will lead to "catastrophic economic consequences." And yet, none of these so-called "defaults" resulted in an actual default on our publicly held debt or caused economic collapse.

In 1995 and 1996, hundreds of thousands of federal employees were furloughed and many programs were temporarily suspended as a result of the two government shutdowns during this period. Specific areas impacted included:

- **Federal Contractors:** Of $18 billion in Washington, DC, area contracts, $3.7 billion (over 20%) were affected adversely by the funding lapse; the National Institute of Standards and Technology (NIST) was unable to issue a new standard for lights and lamps that was scheduled to be effective January 1, 1996, possibly resulting in delayed product delivery and lost sales; and employees of federal contractors reportedly were furloughed without pay.
- **Health:** The Centers for Disease Control and Prevention ceased disease surveillance, and toxic waste clean-up work at 609 sites was stopped and 2,400 Superfund workers were sent home.
- **Public Safety:** Delays occurred in the processing of alcohol, tobacco, firearms and explosives applications by the Bureau of Alcohol, Tobacco and Firearms; work on more than 3,500 bankruptcy cases reportedly was suspended; cancellation of the recruitment and testing of federal law-enforcement officials reportedly occurred, including the hiring of 400 border patrol agents; and delinquent child-support cases were delayed.
- **Parks, Museums, and Monuments:** Closure of 368 National Park Service sites (loss of 7 million visitors) reportedly occurred, with loss of tourism revenues to local communities; and closure of national museums and monuments (reportedly with an estimated loss of 2 million visitors) occurred.
- **Veterans:** Multiple services were curtailed, ranging from health and welfare to finance and travel.

The markets did not respond to such suspensions in government operations in an overly negative manner. During these prior debt limit episodes, rates on U.S. Securities decreased significantly in two instances (1985 and 2003), increased slightly in 2002, and essentially stayed the same in 1995-96. Furthermore, short-term borrowing rates for the United States government decreased in three of these cases, and increased only marginally in 2002. Therefore, the claim that our creditors would see their investments threatened because payments to contractors were delayed and liquidate long-term trust fund assets (as Treasury has done in the past), has been proven historically incorrect. It is abundantly clear that when the U.S. has reached the debt limit in the past, investors assumed that U.S. securities would be Treasury's top priority.

However, since Secretary Geithner has decided, for reasons unknown, to blatantly politicize the treasury Department and argue that default on the public debt is a possibility, Congress now has a duty to clean up his mess. The Full Faith and Credit Act will simply restore our fiscal reputation to where it was before Geithner's alarmist January 6 letter. Given that both Moody's and S&P have issued multiple warnings about America's credit rating, Treasury's reckless decision to gamble our financial reputation to achieve short-term political gain is irresponsible in the extreme.